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IN THE

Supreme Court of the United States

October Term, 1947

No. 178-183

IN THE MATTER OF THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY, *Debtor.*

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
J. HAMILTON CHESTON, Et Al., Etc., *Respondents.*
No. 9203

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
METROPOLITAN LIFE INSURANCE COMPANY, *Respondent.*
No. 9204

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
CENTRAL HANOVER BANK AND TRUST COMPANY, Et Al., as Trustees, Etc., *Respondents,*
No. 9205

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
THE NATIONAL CITY BANK OF NEW YORK, as Trustee, Etc., *Respondent.*
No. 9206

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
JOHN C. TRAPHAGEN, Et Al., Etc., *Respondents.*
No. 9207

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee, Etc., Et Al., *Petitioners,*
vs.
JAMES G. BLAINE, Et Al., Etc., *Respondents.*
No. 9208

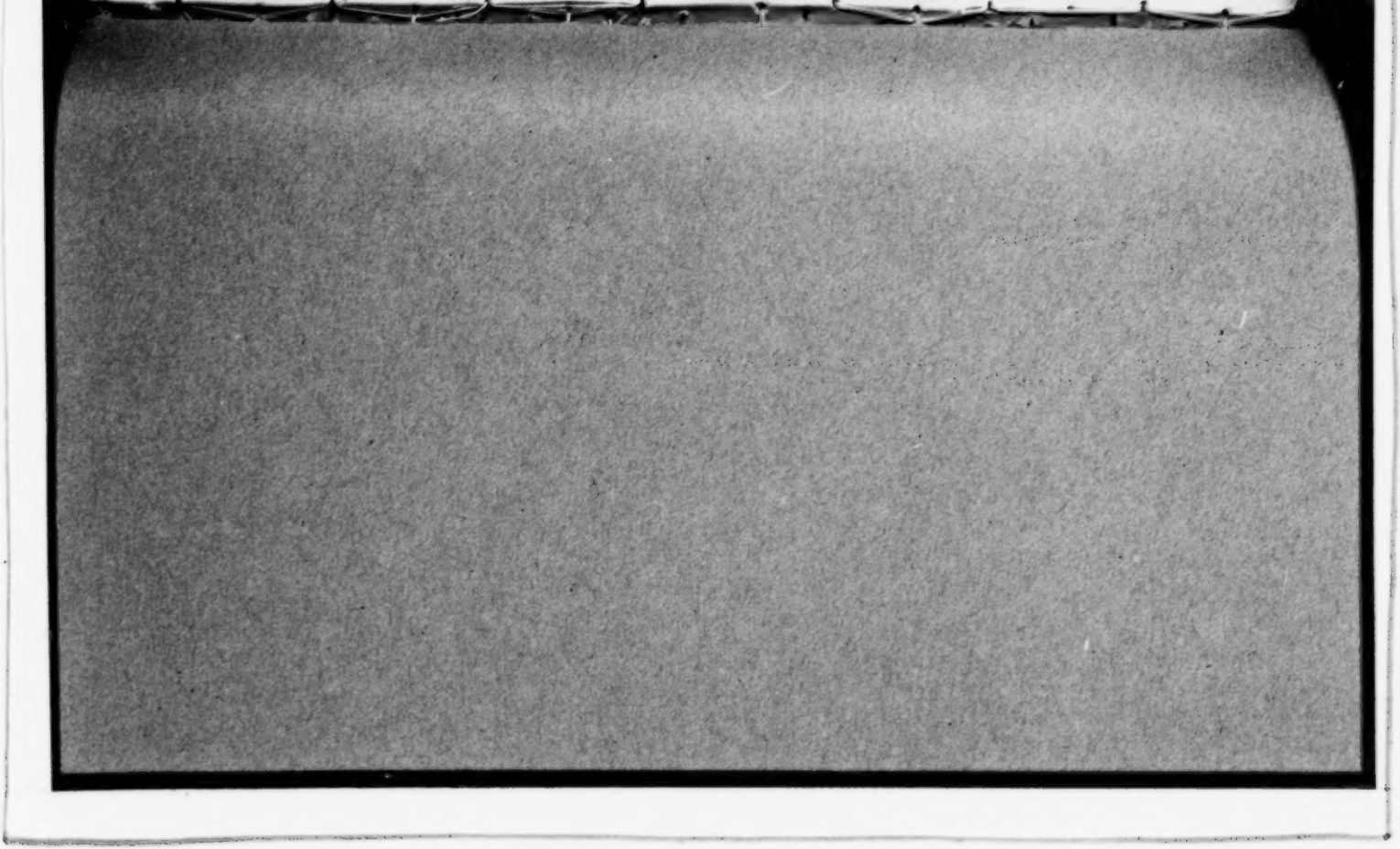
PETITION FOR REHEARING OF THE PROTECTIVE COMMITTEE FOR THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY 7% AND 6% PREFERRED STOCK.

CARTER H. HARRISON, Jr., et al.,
as the Protective Committee for The Chicago, Rock Island and Pacific Railway Company 7% and 6% Preferred Stock.

By LOY N. McINTOSH, Their Attorney
135 South LaSalle Street
Chicago, Illinois

GANN SECORD STEAD
AND McINTOSH
Of Counsel

McCORMICK AND HENDERSON, INC., CHICAGO



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PETITION FOR REHEARING OF THE PROTECTIVE COMMITTEE FOR THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY 7% AND 6% PREFERRED STOCK.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, CARTER H. HARRISON, JR., STEPHEN V. R. CROSBY, CHARLES F. GREY and GEORGE E. PIKE, as the Pro-

tective Committee for The Chicago, Rock Island and Pacific Railway Company 7% and 6% Preferred Stock, respectfully pray for a rehearing of petitioners' Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit in the above entitled cases, which petition for a writ of certiorari was denied by the Court on October 20, 1947; and as grounds for a rehearing your petitioners state:

This Court should reverse the order of the Circuit Court of Appeals for the Seventh Circuit and affirm the order of the District Court remanding the present plan of reorganization to the Commission for further proceedings, upon the general ground that the record discloses material changes in conditions affecting such plan, of a kind not envisaged or considered by the Commission in its formulation of that plan, and that in any event this Court should not conclude from the present record that the Commission did in fact envisage and consider such changes without first requesting the Commission to expressly inform the Court upon such matters.

It is respectfully submitted that this Court should not substitute its judgment, as to the effect of such changed conditions upon the plan, for that of the Interstate Commerce Commission—the expert body whose decisions, under previous rulings of this Court, are final if supported by substantial evidence. (*Eckers* v. *Western Pac. R.R. Co.* 318 U.S. 448; *Group of Institutional Investors* v. *Chicago, M. St. P. & P. R.R.* 318 U.S. 523.)

This Court has recognized the power of the courts to set aside a plan of reorganization, theretofore certified by the Commission, on account of subsequent changes in conditions of a kind not "envisaged and considered by the Commission in its deliberations upon or explanation of the plan". (*Reconstruction Finance Corporation* v. *Denver & R.G.W. R.R. Co.* 320 U.S. 495, 522.)

In the decision here sought to be reviewed, the Circuit Court of Appeals did recognize this principle, but held that material changes, which have occurred in the financial and economic affairs of the Rock Island since the Commission certified the plan on May 1, 1944, were in fact "envisaged and considered" by the Commission in its deliberations upon the plan and that such changes were "forseen and considered by the Commission in formulating the plan." (*Cheston et al.* v. *Chase National Bank as Trustee, et al.*, C.C.A. 7th Cir., January 1947 Session, Nos. 9203-8, Slip opinion, pages 10 and 11.)

In his concurring opinion, denying the writ of certiorari in this case, Mr. Justice Rutledge states that "The record in this case seems clearly to bear out those conclusions".

It is respectfully submitted that the conclusions of Mr. Justice Rutledge and of the Circuit Court of Appeals in this regard are clearly erroneous, for the reason that the record affirmatively shows that the Commission did not "envisage" or "consider" certain vital changes in conditions which have subsequently developed.

Probably the most significant of these changes is that of the earnings and the demonstrated earning power of the Rock Island. It appears throughout the reports of the Commission in this and other railroad reorganizations under Section 77 that earning power has been given *primary consideration* in the determination by the Commission of total permissable capitalization or total valuation of the debtor's properties. Indeed, subsection (e) of Section 77 was considered as expressly requiring such primary consideration of earning power, past, present and prospective.[1]

[1] Subsection (e) provides: If it shall be necessary to determine the value of any property for any purpose under this section the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property and the actual investment therein as may be required under the law of the land in light of its earning power and all other relevant facts.

The courts, including this Court, have consistently upheld the emphasis which the Commission has given to earning power, particularly to prospective earning power, in valuating the debtor's properties and in fixing the limits of permissible capitalizations. Thus, in *Ecker* v. *Western Pacific R.R. Co.* 318 U.S. 448, this Court said that "There is no more important element in the valuation of commercial properties than earnings". In Group of *Institutional Investors* v. *Chicago M. St. P. R.R.*, 318 U.S. 523, this Court stated:

> "It is argued that under this provision earning power is not the primary criterion of value and that the Commission did not give proper weight to original cost, reproduction cost new, or the valuation for rate-making purposes. We disagree. We recently stated in *Consolidated Rock Products Co.* v. *DuBois, supra,* in connection with a reorganization of an industrial company, that the criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations, or disaster, and if the allocation of securities among the various claimants is to be fair and equitable. * * * *
>
> In this case the Commission followed the statute. While it made earning power the primary criterion, it did not disregard the other valuations. It considered them and concluded in subsance that they afforded no reasonable basis for believing that the probable earning power of the road was greater than what the Commission had found it to be by the use of other standards. The Commission need not do more."

In its original report on the Rock Island plan, issued October 31, 1940, the Commission found as to prospective earnings:

> "Despite such savings, the evidence of record convinces us that the estimate by the first and refunding committee of $12,500,000 of earnings available for interest in a normal year is somewhat too high. However,

> earnings available for interest and dividends of approximately $11,000,000 in a prospective normal year are reasonably well supported by the evidence of record, and particularly by the analytical traffic study presented by the first and refunding committee and the estimates of revenues and expenses based on such study.

The "analytical traffic study" referred to by the Commission was made in 1938 and was presented at a hearing on July 20 of that year. The estimates of prospective earnings ran through the year 1942. (242 ICC 298.)

In its supplemental report of January 3, 1944, the Commission did not make any other estimate of future "normal" earnings. It found merely:

> "While the record shows that the current earnings of the debtor are greatly in excess of the estimated 'normal' income of the reorganization company, we do not believe that the economic conditions which made them possible are of such a permanent character as to warrant increasing the total capitalization heretofore approved." (257 ICC 265, 286)

This is the language cited by the Circuit Court of Appeals in support of its assertion in this case that the Commission did in fact forsee and consider the earnings which the Rock Island subsequently has realized.

In its report of May 1, 1944, in which it certified the present plan of reorganization, the Commission merely referred to its previous report of January 3, 1944, as to the current earnings and reaffirmed its conclusions therein stated.

Obviously, in its orders of 1944 the Commission was referred only to the "current earnings", i.e., wartime earnings, which it concluded were caused by economic conditions of such non-permanent character as not to warrant an increase in the total capitalization theretofore approved.

The Circuit Court of Appeals, after quoting these provisions from the 1944 reports of the Commission, concluded that "to us these quotations from the reports of the Commission, whose judgment we are obliged to respect, show the acumen of that body in the consideration of possible economic changes and they put to flight any flimsy contention of the development of unforseen conditions". (Slip opinion, pages 10, 11.)

There is absolutely nothing in this record to show that the Commission ever considered what the post-war earnings of the Rock Island might be or even considered any evidence of prospective earnings, other than that put into this record over nine years ago (July 20, 1938) consisting of estimates of prospective earnings through 1942.

On the contrary, there is explicit evidence that the Commission did not even attempt to envisage or consider, when it certified the present plan in 1944, what the prospective earnings of the Rock Island would be after the termination of the economic conditions occasioned by the war and the arrival of post-war conditions of a "permanent character" which would require an increase in permissible capitalization if materially in excess of the estimated "normal" annual earnings of $11,000,000.

On October 12, 1943, Commissioner Splawn, who was Chairman of the Legislative Committee of the Commission, testified before a subcommittee of the Committee on the Judiciary of the House of Representatives:

> "Of course, we cannot forsee, I think, just what is going to be the situation after the war. If the more optimistic views turn out to be correct, they will have much traffic for a long time and perhaps increase in traffic over a number of years; that is, increase over pre-war traffic. If so, the same situation would obtain for any company not reorganized in the meantime that would obtain now for those reorganizations which are not completed.

"I will not undertake a prophecy as to what will happen after the war. I think it may be different from anything we ever had, because this is a different kind of war from anything we have ever had. How many lives will be spent, how many bodies will be broken, how much of capital will be destroyed, is yet unanswered. No one can possibly foretell or foresee to what extent devastation and destruction may be kept from our land. To what extent new inventions may bring it to us any month, we too cannot forsee. The power of pre-war commercial nations to trade, produce after the war, we cannot yet determine.

"We will probably have many new and difficult problems. If we get out of this war, as we have reason to expect, with most of our capital intact, that is, the forms of capital which are fixed, our buildings and plants, transportation will certainly be a tremendously improved industry, and with the new inventions that may follow, if we do not lose too many of the potential and prospective inventors, may bring on that period of industrial development which we seemed to be approaching when this unhappy conflict was precipitated.

"But, I do not see that it is necessary to answer unanswerable questions when a reorganization is up and the evidence is in."

It is plain from the Commissioner's testimony not only that he would not undertake a prophecy as to prospective post-war earnings, but that he considered it wholly unnecessary "to answer unanswerable questions when a reorganization is up and the evidence is in". It would appear, therefore, that the Commissioner was of the view that, inasmuch as the records of the hearings in these reorganization cases had been closed and all the evidence was in, the Commission had no responsibility or duty to modify, or even to consider the modification of, its previous estimates of future earnings based on the records made years before.

And yet within less than three months following the date of this testimony the Commission issued its report of January 3, 1944, upon which the Circuit Court of Appeals bases its conclusion that the Commission actually foresaw and gave consideration to the subsequent post-war earnings which the Rock Island has experienced. These earnings available for interest (before Federal income taxes) amounted to more than $20,000,000 in 1946. They already equal this figure in the first nine months of 1947, and are presently running at a rate which will produce $28,000,000 or more for the full year, as compared with the Commission's ancient estimate of $11,000,000 [2]—more than 2½ times the foundation figure of the plan. Is this not a substantial change evidencing the obsolescence of the Commission's estimate and constituting "unanticipated large earnings" within the meaning of the *Rio Grande* decision cited by Mr. Justice Rutledge as controlling? (328 U.S. 495.)

While the Commission was wholly silent in its 1944 reports as to what it considered the prospective post-war earnings of the Rock Island might be, the 53rd Annual Report of the Commission to Congress submitted in November, 1939, discloses the attitude of the Commission approximately at the time it formulated the original Rock Island plan. In that report the Commission said:

> "We know from past experience that the upswing in business which war brings is temporary and likely to be followed by an aftermath in which conditions are worse than before." (p. 5)

It was apparently in this spirit (now proved to be utterly unfounded) that the Commission in 1944 adhered to its 1940 estimate of prospective normal earnings of only

[2] Federal income taxes are based on income remaining after deduction of interest accruals. The Trustees' report for the first nine months of 1947 shows $20,202,756 earned for interest (before estimated allowance for Federal income taxes). Federal income taxes amounted to $3,721,188 in 1946, and are estimated at $4,182,000 for the first nine months of 1947 and somewhat over $6,000,000 for the full year.

$11,000,000, which estimate was in turn based upon testimony put into the record in 1938. The shocking disparity between this estimate and the present and prospective peacetime earning power of the Rock Island system, as demonstrated by its annual post-war operations, is in itself a sufficient ground for this Court to affirm the order of the District Court remanding the plan to the Commission. This would be true even though it appeared that the Commission had in fact "envisaged and considered" the post-war earnings of the Road at the time the present plan was finally formulated and certified on May 1, 1944. It is more certainly true in view of the fact that the record discloses that the Commission did not even attempt to forsee the post-war conditions or to consider that factor in the formulation of its plan.

The Commission, in its supplemental report of January 3, 1944, made substantial changes in the plan by reason of the fact that some $38,000,000 was then available for distribution to creditors out of the approximately $82,000,000 of cash and cash equivalents then on hand. Actually, about $34,000,000 was subsequently distributed by order of the court, in accordance with the Commission's report, for retirement of certain obligations and the payment of interest. Even after this distribution and the expenditure of other large amounts for debt reduction (including more than $20,000,000 paid to the R.F.C.), capital improvements, etc., the Trustees have accumulated out of earnings over $92,600,000 in cash and cash equivalents as of October 31, 1947. At least $50,000,000 of this amount is now available for further debt retirements, which would equitably entail further adjustments in the allocation and distribution of securities. As stated below, the necessity for similar adjustments in the Missouri Pacific plan was one of the reasons why the Commission recommended the return of that plan for reconsideration.

That such an additional accumulation of cash, available for distribution, was not in fact "envisaged or considered" by the Commission when it issued its report of May 1, 1944, certifying the plan, is clearly shown by the following statement in that report:

> "While it cannot be said positively that cash distributions in addition to those provided for in the plan could not be made prior to the consummation of the plan, in our opinion, the provisions of Article XVII will not result in any injustice to the interested parties."

Article XVII provides in effect that any new securities, undistributed by reason of the payment or reduction of claims before the plan is consummated, shall be retained *in the treasury* of the new reorganized company. The paradoxical effect of this would be to prevent the present debtor or junior security holders from receiving any benefit from the payment of debt. The better off the road is, the smaller its permissible capitalization! This is indeed a rubber rule, an elastic yardstick of the public interest. However much the debtor paid on account of its debts, the released securities would be retained in the treasury of the new company, and this "corpus", with its liabilities getting smaller and smaller and its assets richer and richer, would pass exclusively to the remaining security holders! Reduced to absurdity, such a doctrine implies that the claims of all but a fraction of the creditors could be paid in full out of the accumulating cash of an estate, and such fractional creditors would then receive the whole estate, to the exclusion of the debtor and other creditors whose interests had been forfeited by the plan.

Surely, the Commission did not foresee and consider that any amount like $50,000,000 would now be available for distribution to the interested parties, over and above working capital requirements and after the payment of heavy income taxes. It could not have meant to assert that the non-allocation of the benefits of distributing any such

amount would "not result in any injustice to the interested parties". That the Commission regarded even a moderate accumulation of cash for such purpose as a rather remote possibility, is demonstrated by the words, *"it cannot be said positively* that cash distributions in addition to those provided for in the plan *could not be made* prior to the consummation of the plan". (Italics ours.) This is not the language of anticipation, or even reasonable surmise. It is rather an express judgment of improbability. Certainly, it cannot fall within the meaning of the doctrine enunciated by this Court as to things "envisaged and considered" by the Commission.

In the brief filed by the Commission with the Circuit Court of Appeals for the Eighth Circuit in the Missouri Pacific case (*Wright et al.* v. *Group of Institutional Investors et al.*), the Commission recommended to the Court that the plan of reorganization "be referred back to it for further hearing and consideration and such revision as it may find to be appropriate". (A copy of the Commission's brief is attached as Appendix "B" to the "Reply Brief of Debtor-Petitioner" in cases numbered 184-189, pages 16-23.)

That there were many other changes in conditions affecting the Rock Island, of a character not "envisaged and considered" by the Commission in the formulation of this plan, is shown under Point IV, pages 9 to 18, of the Reply Brief filed by these petitioners in support of their petition for a writ of certiorari. These changes are very clearly analogous to those described in the Commission's brief filed in the Missouri Pacific case. All of them have occurred subsequently to January 1, 1944, the effective date of the plan, and subsequently to May 1, 1944, the date of the last order of the Commission certifying the plan.

These changes involve, among other things:

1. The payment of obligations and the consequent release of securities previously allocated.
2. Payments on account of accrued interest.
3. Extensive expenditures for improvements.
4. Large accumulations of cash from earnings.
5. Altered circumstances in the selection of Reorganization Managers.

In its brief to the Eighth Circuit Court of Appeals, the Commission says it did not foresee or consider such changes in the Missouri Pacific case when it entered its final order and certified that plan on October 9, 1944. Is it reasonable to suppose (as the Seventh Circuit Court of Appeals in the instant case apparently did), that the Commission did in fact foresee and consider on May 1, 1944, almost exactly the same kind of changes in the Rock Island case as those it did *not* foresee five months later in the Missouri Pacific case?

It is expressly stated in the Commission's brief that it was filed in response to an order of the Circuit Court requesting the Commission's views on the issues presented. The Commission further stated therein that it "has consistently refrained from volunteering its views on new or changed conditions". This statement of the Commission's policy is in accord with that expressed in the response of the Director of the Commission's Bureau of Finance to counsel for the Convertible Bondholders' Group wherein the Director stated that it was not the Commission's practice to recommend to the Court that it return a plan of reorganization for reconsideration and possible revision by the Commission *without a specific request from the Court* for the Commission's views. (Reply Memorandum Brief of Counsel for the Convertible Bondholders' Group in cases numbered 190-193, page 2.)

In view of this declared policy, the letter from the Chairman of the Commission to the Chief Justice, dated October 9, 1947, and discussed in the opinion by Mr. Justice Rutledge, takes on special significance. For although, as Mr. Justice Rutledge points out, "the letter's only positive assertion bearing upon the merits of our disposition is the statement: 'Since the plan was sent to the district court by the Commission, there have been material changes in the situation as it affects the condition of the debtor' ", the inference is inescapable that the changes referred to by the Commission were of a kind not "envisaged and considered" by the Commission in its formulation of the plan certified May 1, 1944, now pending before this Court. Why would the Commission so advise this Court if the "material changes in the situation as it affects the condition of the debtor" were merely changes that the Commission had foreseen and considered in its formulation of the plan in 1944?

Mr. Justice Rutledge summarizes Chairman Aitchison's letter as follows:

> "This letter comes down therefore to a statement that there have been material changes in the debtor's condition since the Commission's approval was given, and to the statement that if the Court finally should remand the case to it the Commission is prepared to do its duty by affording a further full hearing and rendering a further report. In addition the possible though by no means certain inference might be drawn that the Commission may desire another opportunity to consider the plan before it goes to confirmation."

We fully agree with the criticisms elsewhere contained in the opinion as to the form and inadequacy of the Commission's presentation in the letter of its Chairman. But it is respectfully submitted that the pending petitions for writs of certiorari should not be denied for lack of a proper and full expression of the views of the Commission, merely

because of an issue of procedure which readily could be avoided by the entry of an order suggesting that the Commission file a brief herein. The interests of investors in rail securities and of the public in general would seem to require that a readily soluble problem of procedure (as to whether the Commission should volunteer its views or the court invite them) should not stand in the way of an expressly informed decision on the merits of this important controversy. A delay of a week or two, within which time the Commission could file a full brief of its views, is most certainly of trivial consequence, especially in view of the fact that should the pending plan be consummated, more than 60% of the claims of the $32,000,000 principal of Convertible Bonds (the issuance of which was approved by the Commission but a few short years before bankruptcy), as well as all of the stock of this carrier, would be completely eliminated. Before such a drastic consequence of the exercise of governmental powers is given sanction by this Court, it would seem that appropriate co-operation between the Court and the Commission should be effected, so that such a decision may be supported on known facts (to be reported by the Commission), rather than upon this Court's assumption or speculation as to what the Commission really did "envisage and consider" in the formulation of this plan.

The Commission's brief filed in the Missouri Pacific case was expressly directed to the "chief issue" of "whether the conditions of the bankrupt's property have so changed since the closing of the record before the Commission and the certification of the plan to the District Court as to make it necessary or desirable to have further Commission consideration". The filing of a brief by the Commission on the same general issue in the Rock Island case should be suggested by this Court, in the event the Court is of the opinion that, upon the record as it now stands, the order of the District Court remanding the plan to the Commission should not be affirmed.

Wherefore, petitioners respectfully pray for a rehearing of petitioners' Petition for Writ of Certiorari and move the entry of an order by this Honorable Court suggesting that the Interstate Commerce Commission file with the Court a brief of the Commission's views as to the relevant changes which have occurred since the closing of the record before the Commission and the certification of the plan on May 1, 1944, as to whether such changes were envisaged and considered by the Commission in the formulation of the plan as certified, and as to whether the Commission is of the present opinion that the pending plan should be returned to it for reconsideration and possible revision in the light of such changes and all other relevant facts.

Respectfully submitted,

CARTER H. HARRISON, JR., et al., as the Protective Committee for The Chicago Rock Island and Pacific Railway Company 7% and 6% Preferred Stock

By LOY N. McINTOSH, Its Attorney
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Chicago, Illinois

CERTIFICATE OF COUNSEL.

I, LOY N. McINTOSH, counsel herein for the above named petitioner, do hereby certify, pursuant to Rule 33, that the foregoing Petition for Rehearing is presented in good faith and not for delay.

LOY N. McINTOSH

November 14, 1947